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### Compliance Programs: An Alternative to Punitive Damages for Corporate Defendants

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# COMPLIANCE PROGRAMS: AN ALTERNATIVE TO PUNITIVE DAMAGES FOR CORPORATE DEFENDANTS

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## I. INTRODUCTION

Awards of punitive damages in personal injury and property damage cases are claimed to be excessive, lacking in due process, and detrimental to the economic well-being of commercial enterprise.<sup>1</sup> Fear of these awards reportedly causes firms to withdraw goods and services from the market and chills their efforts to develop and introduce new or improved products and services.<sup>2</sup> Though studies show that punitive damage awards are not as common as generally thought,<sup>3</sup> perceptions that the threat of such damages

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1. See, e.g., Victor E. Schwartz & Mark A. Behrens, *The American Law Institute's Reporters' Study on Enterprise Responsibility for Personal Injury: A Timely Call for Punitive Damages Reform*, 30 SAN DIEGO L. REV. 263, 264-65 (1993) (sources cited therein).

2. *Id.* at 265.

3. See Michael Rustad, *In Defense of Punitive Damages in Products Liability: Testing Tort Anecdotes with Empirical Data*, 78 IOWA L. REV. 1, 23 (1992).

is growing continue to drive reform efforts aimed at limiting them. Both legislative and judicial endeavors are underway to better articulate the process for determining punitive damages, including limiting amounts that may be claimed and awarded.<sup>4</sup>

Traditionally, punitive damages law permitted a court to assess punitive damages to punish individual defendants and to deter them and others from engaging in egregious conduct in the future.<sup>5</sup> Today, in contrast, punitive damages are often imposed against enterprises that are typically comprised of a vast array of individual employees. Such enterprises, however, may or may not respond to the same economic incentives as individuals, because an individual's goals may or may not be consistent with those of the enterprise. Further, the structure and decision-making process of the enterprise may not be consistent with identifying inappropriate behavior. The effectiveness of coercing firms to pay large damages assessments as a deterrent to inappropriate behavior, whether in the nature of a criminal fine or a civil damage award, continues to be a topic of much debate.<sup>6</sup>

As described by George Priest, the expansion of liability irrespective of fault, intended to benefit consumers and other plaintiffs who might otherwise be left financially destitute, has increased prices and reduced availability of goods and services for those consumers who can least afford to pay for them.<sup>7</sup> The liability crisis has not resulted solely from the evolution of strict liability; however, this evolution, coupled with reductions in insurance coverage<sup>8</sup> and greater levels of third-party insurance for prospective victims,<sup>9</sup> has exacerbated the crisis.<sup>10</sup> While some commentators anticipated *increased opportunities* for plaintiffs because of increased liability,<sup>11</sup> these additional opportunities have not materialized. Third-party insurance poses problems due to liability for both pecuniary and non-pecuniary losses. Risks are effectively uninsurable because the losses do not result from probabilistic

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4. See Sandra N. Hurd & Frances E. Zollers, *State Punitive Damages Statutes: A Proposed Alternative*, 20 J. LEGIS. 191, 195-97 (1994) (discussing various state statutes that limit the assessment of punitive damages).

5. David G. Owen, *Problems in Assessing Punitive Damages Against Manufacturers of Defective Products*, 49 U. CHI. L. REV. 1, 7-8 (1982). For a discussion of the general principles of punitive damages law, see *id.* at 7-10.

6. See *infra* notes 54-69 and accompanying text.

7. See George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L.J. 1521, 1525, 1567.

8. *Id.* at 1525.

9. *Id.* at 1567.

10. *Id.* at 1524, 1563.

11. See *id.* at 1525, 1567.

causes, and the "variance of risks has been so expanded by tort liability that the risk pools are unsupportable."<sup>12</sup>

The purposes of this paper are (1) to examine the debate over the propriety of assessing punitive damages to punish and deter egregious corporate conduct and (2) to propose an alternative approach for dealing with egregious conduct. After tracing the history and development of the current punitive damages process and exploring the recent constitutional challenges to punitive damages awards, the paper discusses the effectiveness of punitive damages in modifying egregious firm behavior. Next, the paper reviews various proposals that have been made to reform the current process. Finally, the paper concludes by outlining an alternative remedy: court-imposed compliance programs. As discussed below, compliance programs are likely to be more beneficial than punitive damages in two respects. First, such programs offer the opportunity to create organizational structures that will modify the behavior of the company found to have engaged in wrongful conduct. Second, they serve as models that other organizations can follow to minimize the incidence of their own inappropriate behavior.

## II. HISTORY

The doctrine of punitive damages can be traced back at least as far as 2000 B.C. to the Code of Hammurabi.<sup>13</sup> Both the Old Testament<sup>14</sup> and Roman Law<sup>15</sup> provide for multiple damage awards. In eighteenth-century England, courts initially awarded punitive damages in jury cases involving claims of slander, assault and battery, illegal intrusion into private dwellings, and false imprisonment, all of which concerned affronts to the plaintiff's honor.<sup>16</sup> Attempts to provide a rationale for allegedly excessive awards by juries led to explanations that punitive damages not only compensated the plaintiff but also served to punish and deter wrongdoing by the defendant and others.<sup>17</sup> Courts also theorized that awarding punitive damages would reduce the plaintiff's desire for either obtaining revenge or resorting to self-help.<sup>18</sup>

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12. *Id.* at 1583.

13. David G. Owen, *Punitive Damages in Products Liability Litigation*, 74 MICH. L. REV. 1257, 1262 n.17 (1976); see *id.* at 1262-64 (discussing the origins of the punitive damages doctrine and its development in the United States).

14. *Id.* at 1262 n.17 (citing *Exodus* 22:1).

15. *Id.* at 1262-63 n.17 ("[S]everal provisions in classical Roman law prescribed double, treble, and quadruple damages.").

16. Dorsey D. Ellis, Jr., *Fairness and Efficiency in the Law of Punitive Damages*, 56 S. CAL. L. REV. 1, 14-15 (1982).

17. *Id.* at 14 (citing *Wilkes v. Wood*, 98 Eng. Rep. 489 (C.P. 1763)).

18. See Bruce Chapman & Michael Trebilcock, *Punitive Damages: Divergence in Search of a Rationale*, 40 ALA. L. REV. 741, 746 (1989).

Two cases decided as early as 1763, *Wilkes v. Wood*<sup>19</sup> and *Huckle v. Money*,<sup>20</sup> illustrate the courts' desire to avoid the possibility of vigilante justice. In *Wilkes*, the plaintiff initiated a trespass action against agents of the Secretary of State for illegal searches and seizures under general warrants.<sup>21</sup> The court announced that the jury had the power to award damages in excess of the injury sustained. As Lord Chief Justice Pratt stated, "Damages are designed not only as a satisfaction to the injured person, but likewise as a punishment to the guilty, to deter from any such proceeding for the future, and as a proof of the detestation of the jury to the action itself."<sup>22</sup>

Early common law cases challenged the jury's role in determining punitive damages; however, in most instances, the courts gave great deference to the discretion of the jury.<sup>23</sup> Perhaps the first American case in which the United States Supreme Court considered the right of a jury to award punitive damages is *Day v. Woodworth*.<sup>24</sup> In *Day* the Court observed:

It is a well-established principle of the common law, that . . . a jury may inflict what are called exemplary, punitive, or vindictive damages upon a defendant, having in view the enormity of his offence rather than the measure of compensation to the plaintiff. . . . By the common law as well as by statute law, men are often punished for aggravated misconduct or lawless acts, by means of a civil action, and the damages, inflicted by way of penalty or punishment, given to the party injured.

. . . [The determination of punitive damages] has been always left to the discretion of the jury, as the degree of punishment to be thus inflicted must depend on the peculiar circumstances of each case.<sup>25</sup>

In *Minneapolis & St. Louis Railway Co. v. Beckwith*,<sup>26</sup> a late nineteenth century opinion, the Supreme Court ruled that jury awards of punitive damages did not amount to a deprivation of property without due process of law because they were an appropriate means of imposing a penalty that had been recognized for more than a century.<sup>27</sup> As discussed in the following

19. 98 Eng. Rep. 489 (C.P. 1763).

20. 95 Eng. Rep. 768 (K.B. 1763).

21. *Wilkes*, 98 Eng. Rep. at 489-90.

22. *Id.* at 498-99.

23. See Ellis, *supra* note 16, at 12-14 (discussing the courts' concerns with overriding jury discretion to determine damage awards).

24. 54 U.S. (13 How.) 363 (1851).

25. *Id.* at 371.

26. 129 U.S. 26 (1889).

27. *Id.* at 36.

section, many concerns with the jury's role in determining punitive damages have involved constitutional issues similar to those considered by the *Beckwith* Court.

### III. CONSTITUTIONAL PROBLEMS WITH PUNITIVE DAMAGES

The punitive damages process is often challenged as being fundamentally unfair and hence a denial of due process because it allows juries broad discretion to determine punitive damages based on vague standards and leads to unpredictable results.<sup>28</sup> Nonetheless, the Supreme Court has affirmed the jury's authority to determine punitive damages, reasoning that the courts' power to review these awards is adequate protection against abuse of jury discretion or other due process violations.<sup>29</sup> However, recent Supreme Court decisions still show some concern with the broad discretion afforded to juries, although these decisions find that broad discretion is insufficient grounds for a due process violation. For example, in the 1991 case of *Pacific Mutual Life Insurance Co. v. Haslip*, the Court upheld an Alabama jury award that was four times the amount of compensatory damages.<sup>30</sup> Although the common law practice of assessing punitive damages was well-established long before the Fourteenth Amendment was enacted, the Court observed that even a practice that has been recognized for so long does not mean that its use is never unconstitutional.<sup>31</sup> Although agreeing that the award in the instant case did not "cross the line into the area of constitutional impropriety,"<sup>32</sup> the majority expressed concerns about punitive damage awards that "run wild."<sup>33</sup> The Court stated that it could not draw "a mathematical bright line" to distinguish between what is and what is not constitutionally acceptable for every factual situation;<sup>34</sup> instead, the Court limited the proper inquiry to "general concerns of reasonableness and adequate guidance from the court when the case is tried to a jury."<sup>35</sup>

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28. See Owen, *supra* note 5, at 9; Malcolm E. Wheeler, *The Constitutional Case for Reforming Punitive Damages Procedures*, 69 VA. L. REV. 269 (1983). The authority of courts to impose punitive damage awards has also been challenged on other constitutional grounds. In *Browning-Ferris Industries v. Kelco Disposal, Inc.*, 492 U.S. 257, 260 (1989), the Supreme Court ruled that the "Excessive Fines Clause [of the Eighth Amendment] does not apply to punitive damage awards in cases between private parties."

29. See *infra* notes 30-49 and cases cited therein.

30. *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 23-24 (1991).

31. *Id.* at 17-18.

32. *Id.* at 24.

33. *Id.* at 18.

34. *Id.*

35. *Id.*

In the 1993 case of *TXO Production Corp. v. Alliance Resources Corp.*,<sup>36</sup> the Court revealed similar concerns with due process, as well as the diversity of thinking among the justices on the propriety of jury-awarded punitive damages. In applying the *Haslip* reasonableness test to uphold a West Virginia jury's punitive damage award that exceeded five hundred times the amount of actual damages, the Court affirmed that the broad discretion afforded juries to determine punitive damages does not violate due process.<sup>37</sup> In his concurring opinion, however, Justice Kennedy worried that "we are still bereft of any standard by which to compare the punishment to the malefaction that gave rise to it."<sup>38</sup> He also noted that "[t]he Constitution identifies no particular multiple of compensatory damages as an acceptable limit for punitive awards; it does not concern itself with dollar amounts, ratios, or the quirks of juries in specific jurisdictions."<sup>39</sup> Instead, the only fundamental Constitutional guarantee that could serve as a limit on punitive damage awards "is that the individual citizen may rest secure against arbitrary or irrational deprivation of property."<sup>40</sup>

In 1994, the Court revisited the punitive damages doctrine once again in *Honda Motor Co. v. Oberg*.<sup>41</sup> In this case, the Court held that the state's denial of judicial review of the amount of punitive damages awarded violated the Fourteenth Amendment.<sup>42</sup> Noting that the broad discretion granted to juries in assessing punitive damages raised dangers of "arbitrary deprivation of property,"<sup>43</sup> the Court held that *procedural* safeguards such as judicial review were necessary to ensure adequate due process protection against potential abuse of discretion in making punitive damage awards.<sup>44</sup>

In the most recent punitive damages case, *BMW of North America v. Gore*,<sup>45</sup> the Court held that an award of punitive damages which was five hundred times the amount of the plaintiff's actual property damage violated the defendant's due process rights.<sup>46</sup> *Gore* is significant because, for the first time, the Court set forth guidelines for determining the reasonableness of punitive damage awards challenged as excessive. The Court stated that to reduce the likelihood of excessive damages awards, juries considering an

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36. 509 U.S. 443 (1993).

37. *Id.* at 462 (noting that the "dramatic disparity between the actual damages and the punitive award [is not] controlling in a case of this character").

38. *Id.* at 466 (Kennedy, J., concurring).

39. *Id.* at 467.

40. *Id.*

41. 512 U.S. 415 (1994).

42. *Id.* at 432, 434-35.

43. *Id.* at 432.

44. *Id.*

45. 517 U.S. 559 (1996).

46. *BMW of N. Am. v. Gore*, 116 S. Ct. 1589, 1598 (1996).

award of punitive damages might be instructed to examine three criteria: (1) the degree of reprehensibility of the defendant's conduct, (2) the disparity between the harm to the plaintiff and the amount of punitive damages awarded, and (3) the difference between punitive damages and civil penalties authorized for comparable misconduct.<sup>47</sup> These guidelines do not provide a formula for calculating the amount of punitive damages; rather, they appear to provide direction to lower courts without unduly interfering with their discretion.<sup>48</sup> Justices Scalia and Thomas dissented, arguing that although the Fourteenth Amendment affords defendants "an opportunity to contest the reasonableness" of such awards, it does not provide a guarantee that the amount of a damage award will be reasonable.<sup>49</sup>

The effect that the *Gore* guidelines will have on the frequency and the amount of punitive damages awards remains to be seen. Perhaps the uneasiness of those concerned with the constitutionality of the current process for awarding punitive damages has been best expressed by Justice O'Connor, a recurrent dissenter in recent Court decisions where the Court has addressed the issue. She claims that juries need more guidance from the courts in making punitive damage awards.<sup>50</sup> She has stated that although punitive damages were fairly small and seldom awarded as recently as the 1960s, "the frequency and size of such awards have been skyrocketing" in the past few years.<sup>51</sup> Noting that "[t]he increased frequency and size of punitive awards . . . has not been matched by a corresponding expansion of procedural protection or predictability,"<sup>52</sup> she worries that the lack of guidance for juries in assessing punitive damages "heightens the risk that arbitrariness, passion, or bias will replace dispassionate deliberation . . . ."<sup>53</sup> In O'Connor's view, the "skeletal guidance" provided by the courts "permits the traditional guarantor of fairness—the jury itself—to be converted into a source of caprice and bias,"<sup>54</sup> thus violating the Constitution's due process guarantees.

#### IV. PUNITIVE DAMAGES AS AN ECONOMIC INCENTIVE

Another recent topic of debate concerns the effectiveness of punitive damages as an economic influence on organizational behavior. Scholars question the effectiveness of punitive damages on modifying an organization's behavior for at least two reasons. First, a jury may or may not award punitive

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47. *Id.* at 1598.

48. *See id.* at 1598-1603.

49. *Id.* at 1610 (Scalia, J., dissenting).

50. *TXO Prod. Corp. v. Alliance Resources Corp.*, 509 U.S. 443, 474-75 (1993).

51. *Id.* at 500 (O'Connor, J., dissenting) (quoting Ellis, *supra* note 16, at 2).

52. *Id.* at 500.

53. *Id.* at 475.

54. *Id.* at 501.



damages in a given case, but the jury award must be based upon and supported by evidence. Second, if the jury does award punitive damages, the amount awarded may or may not be extremely large; however, the amount also must be based upon evidence.<sup>55</sup> Some legal and economic commentators suggest that such uncertainties will serve as a positive economic incentive. According to Professor Rustad, for example, punitive damages perform their historic function as an effective social control device to the extent that these uncertainties frighten corporate executives.<sup>56</sup> In his view, the threat of punitive damages establishes "an even playing field by depriving unethical corporations the opportunity to gain a competitive advantage by shortchanging on safety."<sup>57</sup> The social policy involved is preventing a "race to the bottom" that would result if firms were forced to forego safety in order to compete.<sup>58</sup> Therefore, "society is safer as a result."<sup>59</sup>

Scholars have also advanced other arguments in order to illustrate how punitive damages function as an incentive to deter wrongful behavior.<sup>60</sup> For example, Professor Wells argues that punitive damages are appropriate in cases where all injured persons do not file suit because of the costs or uncertainties associated with the legal process, thus resulting in potential liability for less than 100% of the harm caused by the corporate actor.<sup>61</sup> By imposing punitive damages in this specific case, a corporate actor may be accountable for the harm caused by choosing not to implement those safety precautions that the enterprise would have foregone had punitive damages been prohibited.<sup>62</sup>

Other commentators have questioned the effectiveness of punitive damages as a deterrent on the grounds that the penalty is indeterminate.<sup>63</sup> The very

55. See E. Donald Elliott, *Why Punitive Damages Don't Deter Corporate Misconduct Effectively*, 40 ALA. L. REV. 1053, 1064 (1989). For example, Chrysler won its first trial for a defective tail latch on the issue of punitive damages in 1997 (New Mexico), but then was assessed \$250 million in punitive damages for the same defect. See Kelly Greene, *How a Small Firm Helped Win a Huge Suit*, WALL ST. J., S.E., November 19, 1997, at S1.

56. Rustad, *supra* note 3, at 86 (arguing that fixed civil fines would not effectively deter misconduct in Fortune 500 firms unless the fines were so large as to "paralyze small- and medium-sized manufacturers depriving unethical corporations the opportunity to gain a competitive advantage by shortchanging on safety.").

57. *Id.*

58. *Id.*

59. *Id.*

60. See generally David G. Owen, *A Punitive Damages Overview: Functions, Problems, and Reform*, 39 VILL. L. REV. 363, 377-78 (1994) (discussing the effectiveness of punitive damages as a deterrent).

61. See Michael Wells, Comments on *Why Punitive Damages Don't Deter Corporate Misconduct Effectively*, 40 ALA. L. REV. 1073, 1076-77 (1989).

62. *Id.* at 1077.

63. See Elliott, *supra* note 55, at 1057; see also Ellis, *supra* note 16, at 52-53 ("The law of

uncertainty resulting from the broad discretion afforded juries in punitive damage awards may lessen their effectiveness.<sup>64</sup> According to this view, punitive damages are an effective deterrent only if both liability and the amount likely to be awarded are ascertainable.<sup>65</sup> This conclusion becomes apparent because “tort law as a regulatory system depends on predictability, so that the actions taken *ex post* in one case can be used by others as *ex ante* incentives to guide future behavior.”<sup>66</sup> Accordingly, frameworks that allow broad discretion for assessing punitive damages, “rather than discouraging corporate misconduct, . . . may actually have the perverse effects of decreasing economic incentives for safety, undermining individual responsibility, and encouraging business-as-usual by corporations.”<sup>67</sup> Some defendants will overestimate both the possibility of liability and the amount of punitive damages, while others will underestimate both possibilities, thereby failing to guard appropriately against liability.<sup>68</sup> Commentators also argue that punitive damages are an inadequate deterrent because they can be passed on to customers, shareholders, and employees.<sup>69</sup> Other problems associated with the effectiveness of punitive damages as a deterrent include difficulties in determining both the likelihood of claims and liability and the threshold cost that would deter a firm.<sup>70</sup>

## V. ISSUES IN IDENTIFYING EGREGIOUS BEHAVIOR BY A FIRM

Punitive damage proponents assume that firms are aware of their own egregious behavior such that they should refrain from such behavior.<sup>71</sup> While this assumption perhaps is generally true, firms often are not aware of particular dangers associated with complex products and services.<sup>72</sup> Today,

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punitive damages is characterized by a high degree of uncertainty that stems from the use of a multiplicity of vague, overlapping terms and the extraordinary deference accorded to juries who receive little meaningful guidance.”).

64. See Elliott, *supra* note 55, at 1057.

65. See *id.* at 1057.

66. *Id.* But see Hurd & Zollers, *supra* note 4, at 203-04 (concluding that “[a]n essential element of the deterrent function is the unpredictability of the risk [of punitive damages]”).

67. Elliott, *supra* note 55, at 1057.

68. Ellis, *supra* note 16, at 57.

69. See Christopher A. Wray, Note, *Corporate Probation Under the New Organizational Sentencing Guidelines*, 101 YALE L.J. 2017, 2020 (1992).

70. See *infra* notes 71-84 and accompanying text.

71. See *infra* notes 71-84 and accompanying text.

72. A similar phenomenon may occur when a corporation commits what has been called “structural crimes.” See Note, *Structural Crime and Institutional Rehabilitation: A New Approach to Corporate Sentencing*, 89 YALE L.J. 353, 358 (1979). Structural crimes exist when egregious activity clearly has been committed, but responsible individuals cannot be identified. These crimes usually occur in one of two patterns. In the first case, appropriately described as

because firm structure may determine the division of tasks, a firm's awareness of its own egregious behavior may be quite different from what it was a century or so ago.

The concept of punitive damages evolved in Anglo-American law two centuries ago as a means of punishing and deterring individuals in civil cases.<sup>73</sup> Although the prospect of a punitive damages award may influence an individual's behavior, firms are not necessarily analogous to individuals. Some commentators suggest that firms are more than rational profit-seeking enterprises and define them as entities in which various divisions and individuals pursue their own goals which may or may not be the same as those of the firm.<sup>74</sup> Because an individual's goals may be contrary to the firm's objectives, questions exist as to whether individuals within the firm are deterred by the prospect of punitive damages against the firm. As a result of the different incentives that may influence an individual's behavior, firm deterrence mechanisms may not effectively deter an individual within the firm from engaging in inappropriate behavior. For example, a manager may knowingly violate safety or environmental regulations to further personal career goals.<sup>75</sup>

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a "good faith" failure, a victim cannot identify the responsible individual because no one acted in a willful or wanton manner. *Id.* at 359. Yet, if a corporation chose not to test for the risk of harm because the corporation expected to find a problem, then the corporation's inaction may in fact be reckless, making punitive damages appropriate. In the second case, individuals may have acted egregiously, but a thorough investigation does not disclose the identity of the responsible individuals. In this scenario, the structural composition of the organization has arguably allowed the "culpable parties to shield their guilt" from those seeking redress. *Id.* The first case is a result of the organization's failure to hold particular individuals accountable for particular tasks, decisions, and responsibilities, while the second case is a result of systemic deficiencies in either the transmission of information or the delegation of responsibility. *Id.*

73. See Owen, *supra* note 13, at 1262-64. Difficulties exist in trying to apply punitive damages designed to punish individual behavior to organizational standards. Professor Owen illustrates this proposition by explaining that an individual is responsible when operating an automobile in such a way that knowingly could kill or injure others. However, liability does not necessarily accrue because automobiles are designed with the knowledge that they will kill or injure. *Id.* at 1257, 1262-64; Owen, *supra* note 5, at 16; see also Fred L. Rush, Jr., *Corporate Probation: Invasive Techniques For Restructuring Institutional Behavior*, 21 SUFFOLK U. L. REV. 33, 42 (1987) ("An employee's act may be guided by purely personal monetary gain and may involve bribery, pay-backs, or crimes of financial concealment. Furthermore, the employee's motivation may be purely political, designed to garner praise and promotion from superiors, admiration from peers, or to sabotage a rival's career."). Because corporations are not "unitary rational actors," managers and employees may act on personal factors totally unrelated to factors that a firm considers in maximizing profits. *Id.*

74. See, e.g., Wray, *supra* note 69, at 2020 (calling the corporate offender "a complex entity in which subunits, auxiliary divisions, and middle managers pursue their own 'subgoals'").

75. *Id.* But cf. Rush, *supra* note 73, at 43 (stating that some economists advocate imposing internal sanctions in order to align individual behavior with firm standards).

A second problem is that liability is sometimes not determined until years after the responsible persons move either to other positions within the firm in question or to other firms.<sup>76</sup> That is, decision-makers responsible for a product that results in the firm incurring punitive damages liability may no longer be present or making decisions involving products at the time the jury awards punitive damages to the victim.<sup>77</sup> Thus, the enterprise may reason that no corrective response is necessary because the responsible individuals are no longer associated with the firm.

Third, in a corporate enterprise, the firm's structure may prevent a victim from attributing egregious behavior to a particular person.<sup>78</sup> Numerous persons in different positions within the firm may contribute to the particular end decision challenged years later in a courtroom as egregious.<sup>79</sup> In a products liability case, if questions of defectiveness arise, the combination of persons responsible for the defect may be unclear.<sup>80</sup> Top management, though ultimately responsible, may not in fact have exercised sufficient care to become informed of potential dangers associated with the design, manufacturing, or labeling of a product, because they assumed that individuals at lower levels would address liability issues. Similarly, those performing the design, manufacturing, and labeling processes may not have considered the dangers or liabilities that could result from such damages, perhaps assuming that such considerations were the responsibility of top management.<sup>81</sup> Further, given

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76. See Elliott, *supra* note 55, at 1063; Owen, *supra* note 5, at 14 (questioning the fairness of punishing firms "for decisions that were made . . . by men and women who since have left the company and perhaps this life") (citation omitted).

77. See Elliott, *supra* note 55, at 1063; see also Owen, *supra* note 5, at 15 ("[E]ven the responsible executive at the end of the decisional line can possess only a small bit of the total information involved. Moreover, the corporate owners of the enterprise are usually far removed from most decisions of even the top executives.").

78. See John C. Coffee, Jr. et al., *Standards For Organizational Probation: A Proposal to the United States Sentencing Commission*, 10 WHITTIER L. REV. 77, 79 (1988). Individuals within an organization may not be deterred by those factors that deter an organization because they "are subject to different pressures and incentives and for personal reasons may cause their organization to act illegally, even when it is not in the organization's rational interest (narrowly conceived) to do so." *Id.*

79. See Owen, *supra* note 5, at 15 stating:

When [punitive damages are applied] to the complex bureaucracy of a modern manufacturing concern, the fit is awkward in many respects. Final 'decisions' concerning a complex product are often the result of a splintered, bureaucratic process involving a complicated combination of human judgments made by scores of persons at different levels in the hierarchy who pass on different aspects of the problem at different times.

80. See Note, *supra* note 72, at 357 (observing that the organizational complexity of large corporations "tends to diffuse and to obscure individual responsibility for corporate actions").

81. See *id.* at 358; see also *supra* note 72 (defining "structural crimes" as instances where organizational culpability exists, but no individual or group of individuals can be identified as

turnover, promotions, changing job assignments, and a constantly evolving organizational structure, corporate firms may not be able to identify changes that need to be made to avoid liability for punitive damages.<sup>82</sup> In the worst case scenario, the firm's management may no longer include anyone who was involved in the initial decision that has since resulted in an award of punitive damages against the firm.<sup>83</sup> Thus, the prospect of liability for punitive damages may not necessarily amount to an effective disincentive due to the nature of a firm's present structure.<sup>84</sup>

## VI. PROPOSALS TO MODIFY THE PUNITIVE DAMAGES PROCESS

In response to the dissatisfaction and controversy over the punitive damages process, commentators have proposed and considered an array of measures to modify the process.<sup>85</sup> For example, an American Law Institute (ALI) Study found that the vagueness and uncertainty inherent in the current process of awarding punitive damages have a detrimental influence on American enterprise, discouraging development of new products and encouraging withdrawal of others from the market.<sup>86</sup> The ALI Study recommended that "*reckless disregard* for the safety of others" should be the standard utilized for determining liability for punitive damages,<sup>87</sup> although critics have claimed that such a standard would not significantly aid juries in identifying behavior that is egregious.<sup>88</sup> The ALI Study also recommended that "'clear and convincing evidence'" be the burden of proof utilized by juries in assessing punitive damages.<sup>89</sup> The American Bar Association and the American College of Trial Lawyers have also recommended that the burden

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responsible).

82. See Elliott, *supra* note 55, at 1063.

83. See *id.* at 1063; *supra* note 72 and accompanying text.

84. Cf. Note, *supra* note 72, at 363 (noting that because corporate fines do not directly affect corporate actors or result in any restructuring by managers, corporate fines are not an effective incentive to modify existing behavior).

85. See Owen, *supra* note 60, at 400-13 (cataloging reforms to the doctrine of punitive damages).

86. See Schwartz & Behrens, *supra* note 1, at 265.

87. 2 A.L.I., REPORTERS' STUDY ON ENTERPRISE RESPONSIBILITY FOR PERSONAL INJURY: APPROACHES TO LEGAL AND INSTITUTIONAL CHANGE 248 (1991) [hereinafter A.L.I. REPORTERS' STUDY]. "Reckless disregard" should involve both *conscious advertence* to the risks in question . . . and *gross deviation* from the appropriate standard of care." *Id.*

88. Schwartz & Behrens, *supra* note 1, at 267; see also Owen, *supra* note 13, at 1283 n.135 ("[A]ny definition of the punishable conduct, such as marketing a product in 'reckless' . . . disregard of the public safety will necessarily be quite vague.").

89. See Schwartz & Behrens, *supra* note 1, at 268 (quoting A.L.I. REPORTERS' STUDY, *supra* note 87, at 249).

of proof be raised to the "clear and convincing evidence" standard.<sup>90</sup> In addition, the United States Supreme Court, in *Pacific Mutual Life Insurance Co. v. Haslip*, favorably noted the requirement of some states that a plaintiff meet an increased burden of proof in order to obtain punitive damages.<sup>91</sup>

With respect to admissibility of evidence, the ALI Study recommended that a court should no longer allow introduction of evidence concerning the wealth of a defendant firm; instead, a jury should consider only the profits earned attendant to the particular controversy in question.<sup>92</sup> Because a firm may be comprised of several subsidiaries with activities wholly unrelated to the particular controversy, considering the wealth of the entire enterprise would be unfair to employees, shareholders, and customers of the unrelated subsidiaries.<sup>93</sup> ALI Study recommendations also included having the jury consider punitive damages in a proceeding separate from the proceeding in which it determines liability for compensatory damages<sup>94</sup> and giving the judge primary responsibility for determining the amount of the award once the jury determines that punitive damages are appropriate.<sup>95</sup>

Although punitive damages are not awarded as part of the criminal process, the deterrent and punishment objectives of punitive damages are analogous to those of criminal fines.<sup>96</sup> Alternative measures traditionally used in the criminal process, such as equity fines<sup>97</sup> and pass-through fines,<sup>98</sup> could be applied in the civil law context by requiring a transgressing firm to issue stock to the state in lieu of paying punitive damages to the plaintiff. Professor Coffee has proposed that firms assessed fines in criminal proceedings should be required to issue to the state the number of shares of stock

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90. Schwartz & Behrens, *supra* note 1, at 269 & n.24; Hurd & Zollers, *supra* note 4, at 204.

91. *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 23 n.11 (1990). The Court concluded, however, that the Due Process Clause probably does not require that such a high standard of proof be met in order to merit an award of punitive damages. *Id.*

92. A.L.I. REPORTERS' STUDY, *supra* note 87, at 254-55. *But see* *Browning-Ferris Indus. v. Kelco Disposal, Inc.*, 492 U.S. 257, 300 (1989) (O'Connor, J., concurring in part and dissenting in part) (arguing that any limitation must be made on a case-by-case basis because the "quantum . . . of pecuniary fines neither can, nor ought to be, ascertained by any invariable law . . . what is ruin to one man's fortune, may be a matter of indifference to another's" (quoting 4 Blackstone \*371)).

93. A.L.I. REPORTERS' STUDY, *supra* note 92, at 254-55.

94. *Id.* at 255 n.41.

95. *Id.* at 256.

96. See John C. Coffee, Jr., "No Soul To Damn No Body To Kick": *An Unscandalized Inquiry into the Problem of Corporate Punishment*, 79 MICH. L. REV. 386, 388 (1981); Owen, *supra* note 60, at 382 ("Punitive damages are in the nature of criminal fines, yet defendants are not afforded the usual safeguards of criminal procedure, particularly the benefit of a higher burden of proof.").

97. See *id.* at 413.

98. See Rush, *supra* note 73, at 48.

equivalent to the fine assessed by the court. The state would then turn the shares over to victim compensation funds for sale on the open market.<sup>99</sup>

Pass-through fines present another potential form of corporate punishment.<sup>100</sup> The fines "assess each shareholder a fixed, pro rata share of the fine. The market value of the shareholders' equity establishes the fine's ceiling."<sup>101</sup> Pass-through fines are similar to equity fines, in that they prevent "overspill" on employees, creditors, and option holders.<sup>102</sup> They offer additional benefits because calculation of the fines does not involve determining their effect on the solvency of the firm or suppression of stock prices.<sup>103</sup> Perhaps most importantly, by imposing pass-through fines, "the judge can target the fine to those who are record holders at the time of the infraction, whereas the cash and equity fines cannot exclude innocent current holders."<sup>104</sup>

In addition to these proposals, over half of the states have adopted laws to reform the way in which courts assess punitive damages.<sup>105</sup> These statutes vary in approach, although all seek to curb perceived abuses from the current punitive damages process.<sup>106</sup> For example, some states limit the amount of the award, while others require that a percentage of the award be paid to the state in order to prevent the plaintiffs from receiving a windfall.<sup>107</sup> Still others require a plaintiff to meet an increased burden of proof to obtain punitive damages or provide that liability for punitive damages and the amount of the award should be determined at separate trials.<sup>108</sup> Although reforms of this type are popular with the business community and tort reform advocates, critics charge that such measures are undesirable as a matter of public policy because they "clearly have the effect of eliminating or significantly diminishing the deterrence function of awarding punitive damages . . . ."<sup>109</sup>

99. Coffee, *supra* note 96, at 413. Issuing stock to the state effectively replaces monetary fines with equity fines, thus avoiding the shifting of corporate penalties to consumers and employees and allowing courts to impose greater penalties on the firm. *Id.*

100. See Rush, *supra* note 73, at 48.

101. *Id.* (footnote omitted).

102. *Id.*

103. *Id.*

104. *Id.*

105. See Hurd & Zollers, *supra* note 4, at 195; Owen, *supra* note 60, at 407-12 (summarizing the common reforms to punitive damages).

106. See *id.*

107. *Id.* at 195-96.

108. *Id.* at 196-97. WRIGHT & MILLER 9 FED. PRAC. & PROC. § 2390 (1971); see Jack B. Weinstein, *Routine Bifurcation of Jury Negligence Trials: An Example of the Questionable Use of Rule Making Power*, 14 VAND. L. REV. 831, 840-44 (1961); see also *supra* notes 87-95 (discussing A.L.I. STUDY).

109. *Id.* at 197; See Hurd & Zollers, *supra* note 4, at 195 (noting that "there is insufficient evidence to demonstrate that there . . . is even a serious problem in the area of punitive

In fact, tort reform critics can voice the same argument about the current proposals to modify the punitive damages process. Current proposals may or may not influence or alter firm behavior—perhaps the most important objective of punitive damage awards from a public policy viewpoint. Although such proposals may limit the circumstances where liability for such damages will arise, they would not obligate or require a defendant firm to alter its behavior. While a reasonable person might expect firms to alter their behavior in order to mitigate the risk of such liability, the firms' internal mechanisms would continue to control the impetus to change. Even if a firm elected to modify its behavior to avoid future liability, the reform proposals do not provide guidelines, checklists, or models to assist the corporation in modifying its present processes.

## VII. ALTERNATIVES TO PUNITIVE DAMAGES

As noted above, a firm's initial design, manufacturing, and marketing is probably unaffected by the threat of punitive damages.<sup>110</sup> However, allowing punitive damages to be awarded excessively may stifle the provision of goods and services desired by consumers, thereby reducing economic benefits generated by commercial enterprise.<sup>111</sup> Limiting punitive damages may reduce the stifling effect that the perceived threat of unlimited potential financial liability may have on the research and development of new products.<sup>112</sup> Yet, this approach may leave consumers at risk should an environment result in which they are exposed continuously to potentially dangerous services and products. After all, consumers are dependent on manufacturers to design and produce products that are not defective and to communicate, via instructions and labeling, information that will minimize the danger of injury. Therefore, limits on punitive damages might lead to an increase of dangerously defective products.

Punitive damages proponents assume that damages will deter or minimize the incidence of egregious behavior in the future.<sup>113</sup> Imposing punitive damages does in fact penalize; however, these damages may not necessarily

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damages”).

110. See Elliott, *supra* note 55, at 1061; see *supra* Part V.

111. See Schwartz & Behrens, *supra* note 1, at 265.

112. See *Browning-Ferris Indus. v. Kelco Disposal, Inc.*, 492 U.S. 257, 282 (1989) (O'Connor, J., concurring in part and dissenting in part).

113. See, e.g., Rustad, *supra* note 3, at 86 (“To the extent that the [indeterminate amount of punitive damages] frightens corporate executives, it performs its historic function as an effective social control device.”). But see, e.g., Elliott, *supra* note 55, at 1059 (“[A]t least in the area of corporate decisions in products liability and other safety-related fields, there is no credible evidence that punitive damages have a substantial deterrent effect.”).



deter.<sup>114</sup> To meet their objectives, reform proponents should institute a triggering process that will encourage corporations to modify or transform their behavior.<sup>115</sup> Yet, absent some requirement that firms analyze and restructure their organizations, behavior may not change. While the award of punitive damages signals inappropriate behavior, such awards neither communicate to the corporations what behavior is appropriate nor provide guidance on how to move toward appropriate behavior. Simply awarding punitive damages fails to focus on the primary objective of the remedy: behavior modification. An award of punitive damages should trigger an organizational analysis; however, requiring firms to pay large sums of money may lead only to the demise of the firm or to the maintenance of the status quo, neither of which is the desired result.<sup>116</sup>

In some jurisdictions, courts are granted discretion both to impose damages and to provide guidance for wayward organizations. For example, a court, applying antitrust law, may choose to correct the behavior of a firm that has engaged in unreasonable restraint of trade by imposing both a damages award and equitable remedies.<sup>117</sup> Likewise, if a court finds that a firm has engaged in other types of egregious behavior, the court should be able to subject the firm to equitable remedies to ensure that the firm's future behavior will be more appropriate.<sup>118</sup>

In sum, punitive damages are not the best manner in which to encourage a change in behavior. Something more is required to assure that the public interest is protected. In addition to requiring corporations to pay punitive damages, perhaps courts could require corporate defendants to analyze their organizations' procedures and to modify those processes that result in increased risk of injury to their product users. In this manner, a court may effectively ensure that risks to the consumers will be reduced as a direct result of a change in corporate behavior.

114. Elliott, *supra* note 55, at 1059.

115. See Note, *supra* note 72, at 361 ("Rehabilitating a corporation requires that its internal operations and procedures be restructured in such a way as to foster future compliance with the law; institutional elements that facilitated the commission of an offense must be modified so that they operate subsequently to prevent violations.").

116. Judicial intervention requiring restructuring may create more efficient results than punitive damages. First, restructuring can modify the internal structural elements that resulted in liability initially. Second, judicial intervention reduces the burden placed on innocent parties such as shareholders and consumers. However, inefficient burdens on the time and resources of the judicial system must be remedied. The courts could use special masters who are paid by the offending corporation to design and implement compliance programs. See *id.* at 365.

117. Equitable remedies are permitted under the Sherman Anti-Trust Act, 15 U.S.C. §§ 1-12 (1994), as well as the Federal Trade Commission Act, 15 U.S.C. §§ 41-58 (1994).

118. See Note, *supra* note 72, at 365-67 (discussing the merits of judicial intervention in internal corporate processes as a means of deterring corporate crime).

### VIII. COMPLIANCE PROGRAMS

As analysis of the deterrent effect of criminal penalties on firm behavior has led Congress to enact statutory provisions authorizing compliance programs as a means of deterring criminal behavior,<sup>119</sup> the authors propose that a similar program be designed to deter inappropriate firm behavior in civil cases in lieu of, or as an alternative to, punitive damage awards. Compliance programs are frameworks developed and implemented by an enterprise for the purpose of monitoring and modifying employee behavior to minimize the incidence of criminal conduct.<sup>120</sup> Because a primary objective of punitive damages in civil law is to deter inappropriate behavior, compliance programs should be considered as an alternative to punitive damages.

Federal sentencing guidelines authorize courts to require transgressing firms to devise and implement compliance programs both to minimize and modify inappropriate behavior.<sup>121</sup> If compliance programs are a suitable remedy for criminal violations, then they should also be suitable to remedy egregious behavior in the civil law context. A compliance program, designed to modify the firm's wrongful conduct, offers the possibilities of rescuing and reforming an entity so that it may become a more positive contributor to society. Moreover, the cost of devising, implementing, and monitoring a compliance program—a cost thrust upon the firm—may serve as an additional deterrent to the defendant and other firms,<sup>122</sup> thereby reducing the risk of similar inappropriate behavior in the future.<sup>123</sup>

An array of precedent exists where courts and federal agencies have required that firms engage in structural modification. The Foreign Corrupt Practices Act of 1977 requires certain corporations to “devise and maintain a system of internal accounting controls sufficient to provide” specified information.<sup>124</sup> In *United States v. Atlantic Richfield Co.*,<sup>125</sup> the court

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119. See generally Charles J. Walsh & Alissa Pyrich, *Corporate Compliance Programs as a Defense to Criminal Liability: Can a Corporation Save Its Soul?*, 47 RUTGERS L. REV. 605, 610-632 (1995) (explaining the history, theories, and rationales behind corporate liability).

120. See *id.* at 645-649 and sources cited therein.

121. See U.S. SENTENCING GUIDELINES MANUAL § 8B1.2 (1995) [hereinafter SENTENCING GUIDELINES] (authorizing remedial programs to remedy the present harm and to reduce the risk of future harm).

122. See Steven A. Holmes, *Size of Texaco Discrimination Settlement Could Encourage More Lawsuits*, N.Y. TIMES, Nov. 17, 1996, at A20 (noting that Texaco's large settlement “is bound to capture the attention of executives, who may want to review their companies' employment practices”).

123. For example, the NAACP and other civil rights advocates believe that Texaco's voluntary program to restructure its relationship with its minority employees may serve as a model for other corporations to follow. See *infra* notes 152-53 and accompanying text.

124. Foreign Corrupt Practices Act of 1977, 15 U.S.C. § 78m(b)(2)(B) (1994).

125. 465 F.2d 58 (7th Cir. 1972).

found that Atlantic Richfield was engaging in illegal pollution by discharging oil into navigable waters from one of its dock facilities.<sup>126</sup> In an attempt to modify behavior and attain compliance, the Seventh Circuit suspended the statutory sentence requiring a fine and gave Atlantic Richfield sixty days to develop and implement a program to resolve the pollution problem.<sup>127</sup> In *SEC v. Koenig*<sup>128</sup> the Second Circuit approved a designated receiver to analyze and assist the Ecological Science Corporation in complying with SEC regulations. Because the SEC's investigation revealed questionable activities that Ecological Science Corporation appeared unable or unwilling to confront, the court protected both the public's and the stockholders' interests by requiring that a receiver be appointed.<sup>129</sup> In *Hart v. Community School Board*<sup>130</sup> a federal district judge required that a plan be implemented to address a junior high school's racial imbalance.<sup>131</sup> The district judge ordered all parties with interest in the district's educational system to submit plans<sup>132</sup> and appointed a special master to assist the parties in preparing the plan.<sup>133</sup> After the parties had submitted a variety of plans, the special master held hearings and eventually adopted a plan making the school a magnet facility with a 70-to-30 ratio of white to minority students as an enrollment target.<sup>134</sup> Other examples of court-ordered programs aimed at influencing behavior include requiring a bakery to donate fresh baked goods to designated charitable organizations<sup>135</sup> and requiring three large corporations both to donate the services of certain high-level executives to charity for one year and to make financial contributions to that same charity.<sup>136</sup>

In 1973 the Securities and Exchange Commission (SEC) departed from the usual punishment of expelling or suspending accounting firms from practice, finding such punitive measures ineffective to modify firm practices.

126. *Id.* at 59.

127. *Id.* at 61 n.1; see also CHRISTOPHER D. STONE, *WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR* 185 (1975) (discussing Atlantic Richfield's premonition that court-imposed probation would start a "dangerous trend in the law").

128. 469 F.2d 198 (2d Cir. 1972).

129. *Id.* at 202; see also *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1105 (2d Cir. 1972) (upholding the appointment of a trustee to ensure that financial activities were consistent with SEC requirements).

130. 383 F. Supp. 699 (E.D.N.Y.), *supplemented*, 383 F. Supp. 769 (E.D.N.Y. 1974), *aff'd*, 512 F.2d 37 (2d Cir. 1975).

131. *Id.* at 754-58.

132. *Id.* at 756-58.

133. *Id.* at 767.

134. *Hart v. Community Sch. Bd.*, 383 F.Supp. 769, 774 (E.D.N.Y. 1974).

135. See *United States v. Danilow Pastry Co.*, 563 F. Supp. 1159, 1165 (S.D.N.Y. 1983).

136. See *United States v. Mitsubishi Int'l Corp.*, 677 F.2d 785, 787-88 (9th Cir. 1982) (expressing concern that corporate defendants could "just write a check and walk away" from any injury that they caused).

Instead, the SEC issued an order requiring the firm to follow designated procedures fashioned under SEC supervision.<sup>137</sup> In addition, the accounting firm agreed to permit an inspection team from the American Institute of Certified Public Accountants to visit the firm and to report on compliance with the agreed-upon procedures.<sup>138</sup>

These examples illustrate a variety of creative alternatives to traditional punishment, each of which involves the conception, development, and implementation of plans designed to influence the behavior of an organization in a specific manner.

However, questions exist about reducing punitive damages when a manufacturer subsequently modifies a warning label. In *O'Gilvie v. International Playtex, Inc.*,<sup>139</sup> the plaintiff asserted a strict liability tort claim in federal district court in Kansas. Plaintiff alleged that his wife's use of Playtex tampons caused her to develop toxic shock syndrome, a condition that ultimately led to her death.<sup>140</sup> The jury found that Playtex failed to adequately warn of the risk of toxic shock from using the tampon and awarded \$1.5 million in actual damages and \$10 million in punitive damages.<sup>141</sup>

After judgment and apparently at the behest of the trial court, Playtex announced that it was modifying its product warning and implementing a program that would alert the public to the dangers of toxic shock syndrome.<sup>142</sup> In response to this post-trial announcement, the trial court reduced punitive damages to \$1.35 million.<sup>143</sup> Plaintiff appealed, claiming that the trial court abused its discretion.<sup>144</sup>

On appeal, the Tenth Circuit Court of Appeals stated that remittitur is proper only where the "amount of damages awarded is so excessive that it shocks the judicial conscience."<sup>145</sup> Absent such a finding, the jury's award should not be disturbed. Applying this standard, the court of appeals found that the trial court was without the authority to reduce the punitive award. The defendant's state of mind at the time of the injury, rather than the defendant's mitigating conduct subsequent to the injury,<sup>146</sup> that is the important factor in

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137. *Laventhol Agrees to Allow Review by Fellow CPAs*, WALL ST. J., May 24, 1973, at 7; see also STONE, *supra* note 127, at 185-86 (discussing the Laventhol punishment).

138. *Laventhol Agrees to Allow Review by Fellow CPAs*, *supra* note 137.

139. 821 F.2d 1438 (10th Cir. 1987).

140. *Id.* at 1440.

141. *Id.*

142. *Id.* at 1441.

143. *Id.*

144. *Id.*

145. *O'Gilvie*, 821 F.2d at 1448. The trial judge at post-trial hearing reported that sufficient evidence existed to support the jury verdict. *Id.*

146. *Id.* at 1449.

determining whether punitive damages are appropriate.<sup>147</sup> Upholding the reduction of punitive damages based on good faith of the defendant subsequent to the misfortune would "discourage voluntary cessation of injury-causing conduct."<sup>148</sup> If such reductions are allowed, firms will reserve good faith conduct as a bargaining tool to reduce punitive damages instead of voluntarily implementing compliance programs.<sup>149</sup> Playtex modified its warning label without engaging in a comprehensive examination of the decision making with the objective of minimizing conduct that could result in future punitive damages.

## IX. DESIGN OF THE COMPLIANCE PROGRAM

Compliance programs are hardly a strange phenomena to large American firms. Corporations often initiate voluntary compliance programs to shield themselves from liability or to settle pending claims.<sup>150</sup> For example, to settle a race discrimination suit brought by some of its employees, Texaco recently agreed to pay \$140 million in damages and to both develop and implement a comprehensive program to restructure its relationship with its minority employees.<sup>151</sup> Among other provisions, the plan requires Texaco to pay ten percent salary increases to its minority employees. In addition, Texaco's management was asked to appoint a task force that will revise the company's personnel policies by developing new hiring and promotion procedures, creating diversity and sensitivity training programs for the company's managers, and establishing a mentoring program.<sup>152</sup> Although the settlement agreement was "voluntary" and not the result of a court order, it is the type of plan a court should have the authority to require a firm to devise and comply with in order to redress reprehensible conduct in lieu of requiring them to pay punitive damages.<sup>153</sup>

Perhaps the most important objective of a compliance program is to minimize the kind of conduct that subjects the firm to awards of punitive damages.<sup>154</sup> The firm should design a compliance plan structured to fit the

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147. *Id.*

148. *Id.* at 1450.

149. *Id.* at 1449.

150. *See, e.g.,* Kurt Eichenwald, *Texaco to Make Record Payout in Bias Lawsuit*, N.Y. TIMES, Nov. 16, 1996, at A1 (discussing the terms of the settlement as well as Texaco's additional concessions).

151. *Id.*

152. *Id.*; Holmes, *supra* note 122, at A20.

153. Indeed, Texaco's desire to avoid liability for punitive damages under the Civil Rights Act of 1991 likely sparked its willingness to enter into such a large settlement. *See* Holmes, *supra* note 122.

154. *See* Jeffrey M. Kaplan et al., *Living with the Organizational Sentencing Guidelines*, 36

needs of its own particular organization such that the provisions of the program will prevent and detect misconduct.<sup>155</sup> From the plan's inception, personnel at the highest level should be responsible for the evolution and implementation of the program. The Board of Directors and top management should publicly make a commitment to the plan. Both internal and external overseers should participate in the development and implementation of the plan. This form of oversight should focus on the processes for determining the parameters of legal responsibility and for identifying the particular individuals and organizational components responsible for the improper behavior. For example, in a products liability case, the firm should first identify those persons responsible for the inadequate design and then require them to redesign the product more safely and to communicate the nature of the bad design and its cure to others in the organization. Likewise, management should require persons in manufacturing and labeling to identify and cure any failures in their legal responsibilities and should require them to communicate potential problems to the appropriate person. Thus, senior management will become aware of both the potential dangers and the relevant legal issues concerning those dangers. Such a plan would address problems that might arise when senior management and those at lower levels would otherwise assume that another person will address these risks. Agents and outside consultants with legal and organizational expertise should participate in the process to ensure that risks are addressed appropriately. Furthermore, the organization should compare itself to other firms in the industry and analyze how these other firms are satisfying their legal obligations.

Suppose that a firm has recklessly manufactured and sold or distributed unreasonably dangerous products and been found liable for punitive damages. In this case, the plan for the compliance program might provide for the following:

1. The company first should identify employees responsible for the egregious conduct and require them to announce precisely what they did wrong and why what they did was wrong. Next, the company should conduct an ongoing assessment of risks attendant to product design, including monitoring industry and technological developments to ensure that the firm design process is consistent with the latest developments.

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CAL. MGMT. REV. 136, 144 (1993) (discussing internal compliance programs).

155. See SENTENCING GUIDELINES, *supra* note 121, § 8A1.2 cmt. 3(k); cf. Richard S. Gruner, *Beyond Fines: Innovative Corporate Sentences Under Federal Sentencing Guidelines*, 71 WASH. U. L.Q. 261, 294 (1993) (recognizing that courts can meet both punitive and remedial goals by designing programs that will impact "corporate reputations" and offer "remedial benefits").

2. The company should monitor and compare the firm's manufacturing process to others used in the industry to ensure that the company's quality control mechanisms indicate when its products will not meet safety specifications.
3. The company should implement a process to ensure that the labeling and instructions communicate adequate information so that consumers will use the product for its intended purpose. In addition, the company should attempt to determine possible inappropriate uses and should warn the consumers about the inappropriate usage. Finally, the company should periodically update the labeling and instructions to ensure safe use. This process might consist of an ongoing assessment of possible consumer misuses throughout the design and manufacturing process as well as a review of competitors' products.
4. The company should solicit feedback from customers, lower level employees, and trade association or professional association personnel. This communication should be continuous and ongoing to ensure that the firm is operating at the forefront with respect to innovations and technological developments.
5. Management should assign responsibility on a firm-wide basis in order to satisfy local, state, and federal regulatory requirements. In addition, the firm should question the effectiveness of existing regulations and should seek to improve the regulatory process, particularly when public and consumer safety concerns are at issue.
6. To the extent that installation, maintenance, or other services are offered, the company should include processes to train the personnel and to make sure that they are acting in accordance with professional standards. If employees utilize equipment to render services, a training process should inform the employees as to the appropriate use and maintenance of the equipment.

Obviously, the firm must take adequate steps to ensure that the employees will follow the implemented program. To this end, the plan for the compliance program might provide for some or all of the following:

1. The firm will disseminate to every employee a printed copy of the compliance program.<sup>156</sup> Personnel at the highest level should also orally communicate the provisions to as many employees as possible to stress the importance of compliance and to ensure the cooperation of the employees.<sup>157</sup>

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156. See Kaplan et al., *supra* note 154, at 139.

157. See *id.*

2. High-level personnel should assign responsibility for compliance with various provisions to appropriate divisions of lower-level employees.<sup>158</sup>
3. The firm should schedule regular feedback sessions so that employees at all levels can provide feedback regarding compliance with the plan. In addition, the firm should maintain written minutes of these sessions in order to compile a sufficiently detailed record of the firm's ongoing compliance efforts.
4. Specially-designated employees of the firm should monitor the firm's compliance efforts and should periodically report the results of the program to a court-appointed special master. These reports should continue for the duration of the compliance program.
5. The monitors of the program should assess compliance violations in order to determine whether they reflect either an enterprise morale problem or deficiencies in the process. Additional auditing and monitoring systems should "enabl[e] employees to report suspected violations without fear of retribution."<sup>159</sup>
6. The plan should also include a process whereby it can be modified or updated in appropriate situations; however, material changes should require court approval.

In addition to monitoring compliance, the plan should set forth a system of discipline to ensure that the compliance process functions effectively,<sup>160</sup> designating appropriate penalties for failure to participate or act in accordance with the process in the compliance plan.<sup>161</sup> Although a system of discipline and an effort by top management to communicate the importance of the plan to all employees are important for the program to be effective, the program's success will ultimately hinge on the commitment that top management demonstrates to the program, including its willingness to discipline those who fail to act consistently with the plan.<sup>162</sup>

In addition to or as part of the compliance program, a court may require a firm found to have engaged in egregious conduct to perform remedial community service.<sup>163</sup> Provisions in the U.S. Sentencing Guidelines provide for that possibility in criminal cases where the defendant organization

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158. Likewise, management should carefully assign responsibility only to those employees who are unlikely to engage in misconduct. *Id.* at 140.

159. *Id.* at 140-41; *see also* Kaplan et al., *supra* note 154, at 141 & n.24 (discussing the consideration a corporation should make when encouraging employees to report suspected violations).

160. *Id.* at 141-42.

161. *See id.*

162. *See id.* at 139-40.

163. *See* United States v. Mitsubishi Int'l Corp., 677 F.2d 785 (9th Cir. 1982).



possesses knowledge, facilities, or skills that uniquely qualify organization personnel to repair damage caused by the offense.<sup>164</sup>

Along these lines, firm requirements might include: (1) mandatory publication of a corporate offender's past inappropriate behavior to encourage heightened monitoring of subsequent corporate behavior in private relationships;<sup>165</sup> (2) design and implementation of a court-supervised compliance program;<sup>166</sup> and (3) additional compulsory reforms in compliance practices which would reduce the likelihood of inappropriate conduct in the future.<sup>167</sup>

A compliance program should be a preventive tool.<sup>168</sup> Once a compliance program is in place, it should have a "self-correcting effect" on the propriety of how a firm conducts its business.<sup>169</sup> Compliance programs may be even more effective when successful compliance, as determined by the court, will reduce or eliminate the firm's obligation to pay punitive damages.

## X. CONCLUSION

Agreement exists that the settlement process is a necessary response to an increasing number of controversies that, because of numbers of parties or nature of issues, do not lend themselves to usual trial court process.<sup>170</sup> The settlement process offers innovative and creative possibilities in response to disputes, but at a cost of uncertainty of process and procedure that can raise questions of fairness and due process.<sup>171</sup> The exact nature of a plan cannot be known in advance. The role of a master should be defined, and judges

164. SENTENCING GUIDELINES, *supra* note 121, § 8B1.3 commentary.

165. See *id.* at § 8D1.4(a); Andrew Cowan, *Scarlet Letters for Corporations? Punishment by Publicity Under the New Sentencing Guidelines*, 65 S. CALIF. L. REV. 2387 (1992); Andrea A. Curico, *Painful Publicity—An Alternative Punitive Damages Sanction*, 45 DEPAUL L. REV. 341 (1996).

166. See *supra* notes 154-62 and accompanying text.

167. See SENTENCING GUIDELINES, *supra* note 121, at § 8D1.1 (explaining conditions and enforcement of probation).

168. See Robert J. Rafalko, *Remaking the Corporation: The 1991 U.S. Sentencing Guidelines*, 13 J. BUS. ETHICS 625, 627 (1994).

169. *Id.* While this article analyzes the steps for implementing a corporate compliance program under the 1991 U.S. Sentencing Guidelines, the authors conclude with two points, both of which may apply to the creation of a compliance program in the punitive damages context. First, a set of guidelines will insure that a firm serves the needs of society in a responsible manner by producing desired products and services and by generating profits and returns on capital. *Id.* at 634. Second, guidelines will assist employees in maintaining their "ethical integrity" as they attempt to serve the corporation. *Id.*

170. See Wayne D. Brazil, *Special Masters in Complex Cases: Extending the Judiciary or Reshaping Adjudication?*, 53 U. CHI. L. REV. 394, 410-14 (1986).

171. See Peter H. Schuck, *The Role of Judges in Settling Complex Cases: The Agent Orange Example*, 53 U. CHI. L. REV. 337, 362 (1986).

should not abdicate to masters.<sup>172</sup> Fairness will be best addressed if the parties, their attorneys, the judge, and masters or other appointed experts are all actively involved in the settlement process.<sup>173</sup>

As proposed, compliance programs should not pose the broad array of uncertainties that may be incidental to a settlement process. Generally, a court should not implement compliance programs until after a trial court proceeding where findings of fact and application of law have resulted in a decision finding the defendant's behavior to be egregious. If the court finds the development of a compliance program appropriate, the defendant must carry the burden both of developing and of presenting a proposed plan to the court for approval. A master or other expert may be utilized in this process. Further, the proposed guidelines for developing and implementing a compliance program provide a pre-existing format that often does not exist to guide the initial stages of a settlement process.

Due to concerns that punitive damage awards are frequently unfair and detrimental to the economic well-being of a commercial enterprise, numerous reform efforts are currently underway to better define the process for determining punitive damages, including limiting amounts that a plaintiff may receive. By decreasing deterrence, ongoing reform efforts by Congress and the states to limit punitive damages will increase the need for other measures to modify inappropriate firm behavior. Although limitations on dollar liability minimize the potential financial harm that an enterprise may experience, these limitations are likely to decrease the probability that firms will modify inappropriate behavior likely to result in harm to others, because the incentives to avoid inappropriate behavior are reduced.

In contrast, limitations on punitive damages provide more certainty when a firm factors its risk calculations, creating an opportunity for the firm to analyze liability as an economic issue rather than a social issue. Limitations on punitive damages and the subsequent failure to address inappropriate behavior may invite public demand for new sanctions that may be at least as burdensome as the liability for punitive damages from which corporations are attempting to escape.

Compliance programs could help offset the decreased deterrence brought about by abandoning punitive damages. Because a primary public policy objective of imposing punitive damages is to deter future inappropriate behavior, compliance programs could serve as a viable alternative to punitive damages. They offer an opportunity to create an organizational structure that would not only modify firm behavior but might also serve as a model that

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172. See Brazil, *supra* note 170, at 417-20.

173. See Francis E. McGovern, *Toward a Functional Approach for Managing Complex Litigation*, 53 U. CHI. L. REV. 440, 446-447 (1986). But see Shuck, *supra* note 171, at 359-365 (cautioning against judicial over-involvement).

other organizations could follow in order to minimize the incidence of their own inappropriate behavior.